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Q2 & H1 FY17 Earnings Conference Call Transcript
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Karl Kolah: Good evening and thank you for joining us on Vaibhav Global's results earnings call for the quarter and six months ended 30th September, 2016. Today, we have with us Mr. Sunil Agrawal, Chairman and Managing Director and Mr. Puru Aggarwal, the Company's Chief Financial Officer.

We will begin the call with brief remarks by Mr. Puru Aggarwal on financial performance followed by a discussion on the business operations, key initiatives and broad outlook by Mr. Sunil Agrawal. Following the management's opening comments; we will open the forum for your questions. Before we get started, I would like to point out that some of the statements made or discussed on today's call may be forward looking in nature and must be viewed in conjunction with the risks and uncertainties faced by the company. A more detailed statement and explanation of these risks is included in our earnings presentation. The company does not undertake to update these forward looking statements publically.

I would now like to invite Mr. Puru Aggarwal to start proceedings on this call. Over to you.

Puru Aggarwal: Good evening everyone. I warmly welcome you all to Vaibhav Global's Q2FY17 earnings call. I will begin with an overview of the key financial highlights for the quarter under review.

The performance trajectory has been positive for the quarter under review. Revenues in Q2FY17 were higher by 15.5% YoY on net basis at Rs. 345 crore. This is on account of improved performance in our TV and B2B sales. TV revenues were higher by 10% YoY to Rs. 242 crore on account of higher volumes and marginally higher ASP. Our two main initiatives Budget Pay EMI scheme and Easy returns policy have been helping us gain customer traction. Our focus has been to sell higher quality product to customers translating to improvement in average realizations.

Gross margin in our US B2C operations has marginally expanded in the quarter. However, overall gross margin stood at 59% as compared to 65.5% in Q2F16, due to significant depreciation of GBP and higher revenue contribution from B2B.

EBITDA (without exchange gain/loss) for the quarter stood at Rs. 16.9 crore from Rs. 18.8 crore in Q2FY16, despite significant negative impact of GBP on UK revenue translation. Depreciation costs for the quarter were higher at Rs. 7.1 crore compared to Rs. 6.2 crore last year on account of investment in SEZ, US warehouse, expansion in US households and IT. Profitability for the quarter stood at Rs. 7.3 crore versus Rs. 12.1 crore in Q2 last year. We are continuing to see positive operating cash flow, which was Rs. 23 crore. More importantly, Free Cash Flow stood at Rs. 13.5 crore despite CapEx of Rs. 9.2 crore during the quarter under review. This will enable us to move towards debt-free status once again.

With these comments, I now hand over the discussion to Mr. Sunil Agrawal to share his views on the business.

Sunil Agrawal: Thank you, Puru. I welcome you once again to Vaibhav Global's Q2FY17 earnings conference call.

Puru has given you an update on the financial performance for the quarter under review. I will give you an operational update and some strategic thoughts for growth going ahead. I am glad to state that we continue to maintain positive momentum of the previous quarter inspite of TV viewership bearing some impact of the US presidential debates and the adverse effect of pound devaluation on INR translation of UK revenues.

In the past one year we have undertaken several operational initiatives which are now beginning to bear fruit. The EMI initiative through budget pay is drawing encouraging response with 22.5% sales generated from Budget Pay orders in H1FY17. It must be noted that we are offering this only on TV and on items above $20. In our other key initiative, returns policy, we are focusing on rationalizing returns and have successfully reduced the average return rate q-on-q, so as to increase our net revenues.

Our strategic focus has been to develop and grow in-house brands, both in fashion jewelry and life style. Our in-house brands are aiding deeper customer relationship and allowing us to improve realizations. Brands such as Royal Jaipur, Tribal Collection of India, Pearl Expressions, Living Gold, Milaan etc. are performing very well with great response from customers. Well known designers- Rachel Galley, Lucy Q, Guiseppe Perez are also doing very well at our Channels. They are exclusive to us for TV shopping and we manufacture products for them. We constantly evaluate the performance of our brand portfolio through customer feedback.

In addition to brand development, we continue to improve the overall customer experience with initiatives such as improved programming, better logistics, storytelling and bringing expert guest on air. A proficient technology-oriented senior management team is now in place and we are focused on technology upgrades and best in class customer interfaces to deliver value.

We have now expanded presence to 87 million households in the US and are deepening our direct engagement with buyers through aggressive marketing initiatives. We have several new exciting initiatives planned this quarter. During the current quarter, we will launch Budget Pay on the web platform in US and Budget Pay on TV in UK. We also expect to launch much advanced mobile Apps as well as Smart TV App for US and UK shortly.

Let me now highlight some vital customer-centric data points. In Q2FY17, we have added 47,100 new customers and now serve 347,600 unique customers; this is calculated on an annualized basis. Repeat buying activity of our customers is at 17.3 times as against 17.2 times in the previous year. Average selling price in the quarter has been $25.7, compared to $22.4 YoY. Average annual purchase by each customer is at 24.7 pieces during the year as compared to 25.5 pieces in the previous year. Customer retention rate is now at 44% in the US and 50% in UK.

To conclude I would like to say that we have witnessed second successive positive topline growth. Despite Brexit concerns, the UK business performance has accelerated. In the US, we are monitoring TV viewership trends in Q3 as the presidential elections draws closer. We expect to see strong demand in the upcoming holiday season thereafter. With Budget Pay expected to be implemented on web and technological initiatives undertaken, we expect web volumes to pick up in the second half. Gross margins are expected to remain healthy at current levels in the second half of FY17. We are confident that a return of volume growth will drive EBITDA margin expansion as we benefit from better operating leverage. Most of our investments such as expanded manufacturing facilities and increasing household coverage have already been carried out so fixed cost may not increase substantially from here on. As intimated earlier, we plan capex of $ 4-5 million during FY17,which will enable healthy cash flow generation going forward. Our current growth momentum combined with above mentioned initiatives gives me confidence that the Company will continue the growth momentum in the future

With that I conclude my opening remarks and I request the operator to open the forum for questions.

Moderator: Thank you, sir. Ladies and Gentlemen, we will now begin with the Question-and-Answer Session. The first question is from the line of Gopinath Reddy, who is an individual investor. Please go ahead.

Gopinath Reddy: My question is regarding the fundamental thing that people say is fashion and low cost will not go hand-in-hand. In that my doubt is we are focusing on improving the technology, improving the ease of using the Web or app and this stuff and giving lowest price as our selling point as compared to the competitors. Are we giving any thought towards this thing that is low pricing damaging our not letting us improve our sales vis-à-vis the competitors?

Sunil Agrawal: We address specific segment in the value chain. We position ourselves as a discounter. There are many retailers in US which position themselves in such a fashion but only in brick-and-mortar. So Walmart, Target, Lowe’s, TJ Max, Marshall, so they all are in to lower price point, but they still have their in-house brands and some third-party brands but into lower price points. On electronic commerce, we position ourselves similar to them. So I do not agree that the fashion and low price do not merge. People who cannot afford lot of money would still like to be fashionable and still like to buy blain or nice looking thing if possible branded, if not generic brands.

Moderator: Thank you. The next question is from the line of Sunil Jain from Nirmal Bang Securities. Please go ahead.

Sunil Jain: Sir, this volume growth which has come in TV sales, is this including return or without including return?

Sunil Agrawal: This is net of return.

Sunil Jain: So we had seen year-on-year increase of 5% in volume?

Sunil Agrawal: Correct, you have seen year-on-year increase.

Sunil Jain: There is a reduction in gross margin and that too substantial as compared to last quarter or maybe last year or even if we see last many quarters. So you had said that one of the reasons is GBP. Apart from that, anything else which we can point out and how much is the impact of GBP?

Puru Aggarwal: Let me break it down; the currency plays out in more than one way. One play is that individual companies do have their own currency impact in their books, second is India when supplies to these companies, India books has currency impact and third currency impact is when a consolidation is done, meaning the P&L of all the companies when they are translated into INR at that time there is a notional translation gain or loss happens. So the first two are actual and third one is notional. So the notional impact this time has been very big because of devaluation with GBP; just to give an idea in Q2 it is more than Rs. 2 crore and in H1 it is more than Rs. 7 crore. Now, this is notional only, it is not actual, it is only translation. In the book actually if you look at the result, the currency gain is Rs. 50 lakhs compared to Rs.1.5 crore of a comparable quarter.

Sunil Jain: You mean to say whatever the profit you have earned in UK book, that is not in GBP, that has not impacted much whereas…?

Puru Aggarwal: GBP in UK books remain GBP.

Sunil Jain: But the procurement must be from say China or maybe from other country, so there your cost must have increased, if I am not wrong?

Puru Aggarwal: Since invoicing from China also is in GBP. So for UK operations it remains the same.

Sunil Jain: Only the major impact was from there to conversion into rupee?

Puru Aggarwal: Yes.

Sunil Agrawal: Conversion to rupee from bottom line Sunil ji. Earlier exchange rate would have been Rs.4 crore profit addition to the bottom line. But actual addition for the H1 has been only Rs.15 lakhs from UK. In conversion we lost almost Rs. 4 crore.

Sunil Jain: But it is going to reverse or will this remain like this?

Sunil Agrawal: It will reverse, the reason is the opening inventory and closing inventory at different valuation. So once the pound stabilizes, whatever the level, then it will go away, for example, if the pound stabilizes at current level, it is currently Rs. 83.5 and the last conversion that happened was around Rs. 86. So the current quarter will have small impact, but if it stays at Rs. 83 now, the next quarter will have no impact, as all the profit will flow, although at Rs. 83 but will flow to the consolidation accounts.

Sunil Jain: How much was the return rate in the current quarter?

Sunil Agrawal: Q2 is 15% in US and in H1 it is 17% in US.

Sunil Jain: If I am not wrong, this Q2 is generally your season where you said you come out with lot of discount sale. So has that impacted the realization in US or this was what you are talking like you are trying to reduce the prices and that is the impact?

Sunil Agrawal: The return, we initiated two initiatives in US last quarter, one is not to take returns on our rising option platform and also not to take returns on the clearance sale. So that helps during this current quarter where we had clearance sales, our returns go lower because of not taking return of clearance.

Sunil Jain: Clearance is there was no return and rising sales also there is no return?

Sunil Agrawal: Yes, correct.

Sunil Jain: But your maximum sale is through rising sales?

Sunil Agrawal: Rising sale has been muted, but there is a rising auction on the Web platform, which is a small component of total overall sales, the TV is actually falling price auction.

Sunil Jain: I was talking about the realization in the US which has come at $23 against last quarter $27 and last time you had suggested that this price is a bit higher and you want to bring it down. So this is the only impact or in this quarter normally you have more of a clearance sale, so average realization come down, because next quarter will be higher or will be at this level?

Sunil Agrawal: US average price point in Q2 was $19 compared to last year same quarter $22.6. UK it is a little higher; it is at $25 compared to $20 earlier same period last quarter. So when you look at average, it is $22.4 compared to $25.7, average of same quarter last year. So it actually has come down.

Sunil Jain: I was just trying to understand what is the reason means why the prices have come down – was it intentional or was it because of clearance sale?

Sunil Agrawal: This was a bit of conscious decision by us in the US because we found that at lower price point the repeat purchase and retention was better. So we bought the price point back down slightly so as not to lose the customer who are loyal to us because of lower price point…lower price point we found that people perceive us unique positioning and that actually led to our growth in volume and growth in total revenue.

Sunil Jain: So this volume growth which has come year-on-year, can this sustain, sir… any guidance for the balance second half?

Sunil Agrawal: We expect balance second half and coming mid to long run our growth continuing in double-digit.

Sunil Jain: This gross margin where it can again bounce back?

Sunil Agrawal: Gross margin this particular quarter were lower because B2B sales is literally higher as you might have seen from the presentation, but our retail margin are stable as they were quarter-over-quarter, this quarter is generally slightly lower because of clearance, but they are stable, in fact, the US is 1% higher year-over-year in the gross margin.

Sunil Jain: If we exclude the impact of GBP and this impact of higher B2B sales, the gross margin were stable?

Sunil Agrawal: They are very stable, in fact, in US we are 1% higher year-over-year, UK was 1% lower.So when you look at overall average,minuscule they are higher than last year.

Sunil Jain: Again on this Web sales, still we are struggling. Anything which you would like to comment on this, how we can because again the Web sale even year-on-year 25% decline on the volume, what are you doing to improve this?

Sunil Agrawal: We made a new launch of latest Hybris version of 5.7 and that was launched in middle of July. So we are fixing major launch, the new launch takes some time, because of the history goes away, and we are aggressively promoting starting November, and we expect to regain the volume by the end of this quarter.

Sunil Jain: So in this whatever new Hybris you had launched, suppose someone launches this app on their phone, everything can be done on the phone, is that the procedure what can be done over there…payment can also be done over there and we were facing some problem in that?

Sunil Agrawal: This platform is for Desktop, Phone, Tablet, it is not an app, it is still responsive, so people have to go to the browser and see. So they can buy from the browser. Now the app that we are going to launch that is a separate initiative that will come in early part of November. So that app will be the native app on phone or tablet or any of the smartphones, both in US and UK, so they can do everything from that app also. So this particular launch was responsive website that has to be accessed through browser.

Sunil Jain: This App when we are launching.

Sunil Agrawal: Between 10th to 15th November.

Sunil Jain: Volume has declined by 25%. So apart from this any other reason because you had old version of this thing?

Sunil Agrawal: This is the only reason, nothing else, we have very capable E-com team now, the leader of LC business is E-com background, we also hire a director of E-com who is very capable, our IT Head is E-com background, so we have very capable team now to take this forward. So I am quite confident that volume will pick up on E-com towards the end of this quarter.

Moderator: Thank you. The next question is from the line of Gopinath Reddy, who is an individual investor. Please go ahead.

Gopinath Reddy: This is regarding the investments part that we are doing after this Web Hybris launch. Is there any further investment that we are planning for the foreseeable in a very near future?

Sunil Agrawal: Total plan for the whole year is between \$4 million to \$5 million, Mr. Reddy, out of that we already spent more than \$2 million this financial year, the rest of the projections for the CAPEX is the apps in US, UK for Mobile and Tablet, Smart TV App, that will also be launched before 15th of November. The new studios that we are building up in US, we are building four studios for different products within the same premises, we are not taking new premises and any other IT-related hardware or software activities. Last year was quite substantial, this year is moderate and next year will be even lighter. So going forward, there is not so much of heavy expense expected from the capital point of view.

Gopinath Reddy: Next year what is it going to be sir…is there any concrete plan or just maintenance kind of a thing?

Sunil Agrawal: We have not drawn complete concrete plan for next year yet, but from the limited visibility I have, we do not have many major expense outlined but we think that it may be anywhere between $3 million to $4 million for next year, this year $4 million to $5 million.

Moderator: Thank you. The next question is from the line of Astha Jain from HEM Securities. Please go ahead.

Astha Jain: My question is regarding the cost of material consumed and the manufacturing expenses which have been shown in your financial results this time. So we have seen a huge jump in the cost of material consumed as well as manufacturing expenses. I just want to know the reason behind it and what can be expected in the future on both of these counters?

Puru Aggarwal: Let me answer the direct expenses first which is manufacturing expenses; one reason is that the volume has gone up at standalone as well as at group level in US and UK. In US and UK actually duty is paid on import… so more the sales are the duties. Here actually the production has gone up. Second, we have used more contract labor which has been offset by employees cost. Third is that we have two plants instead of one. So these are the three major reasons. Then in case of material cost, last year we had some old inventory which we had realized higher margin. That is one reason in case of raw material.

Sunil Agrawal: The other reason is that B2B it was quite higher as a ratio this year. So when you look at the gross margin for TV business, gross margin is constant as last year because the ratio of B2B is higher which has much lower gross margin. That is why you are seeing the cost of material being high. Now, as this will normalize, the B2B was more opportunistic sale, we have bought some material in auction and liquidated a large portion of that in last quarter. So we do not expect the B2B to be staying high in coming quarters and the margins will go back to the earlier higher numbers of 62-63%.

Astha Jain: You are saying that in Q3 and Q4 we are not expecting our cost to be increased so much which we are witnessing in this quarter, am I right, sir?

Sunil Agrawal: Correct, one more reason is the Brexit conversion or the pound devaluation when you do the conversion the cost of material goes higher because the opening inventory was at higher value of pound and the closing inventory was at lower value of pound, so the profitability which should have flown into the bottom line has gone is cost of goods. So that also increases the cost of material. As the pound stabilizes at current level, that impact will minimize or go away. So in the current quarter and next quarter it will be pretty much lower. So B2B sales and as Brexit devaluation impact goes away, the material cost will go back to the normal levels. As you saw in FY'13-14-15, we used to have 60, 61% gross margin, in FY15 we had 63% gross margin. So we expect us to go back to the 62-63% kind of gross margin.

Moderator: Thank you. The next question is from the line of Srivatsa S who is an individual investor. Please go ahead.

Srivatsa S: Now that we are seeing sales trend going up, currently, we are doing around Rs.350 crore in sales. So if we reach Rs. 400 crore level, do you think the operating leverage will really start kicking in, any ballpark number I am looking at?

Sunil Agrawal: Our business model is such that our expenses are largely fixed except the warehouse and call center, all operational and air time expenses which are the major portion, they are fixed and the gross margin is quite high. So as we are able to scale back up, large portion of the gross margin should flow to the bottom line.

Moderator: Thank you. Ladies and Gentlemen, I now hand the conference over to the management for closing comments. Over to you.

Sunil Agrawal: Thank you very much for your participation. If you have any further questions, please feel free to reach out to Karl Kolah of CDR India or Puru Aggarwal, our CFO.

Moderator: Thank you very much members of the management. Ladies and Gentlemen, on behalf of Vaibhav Global Limited, that concludes today's conference call. Thank you all for joining us.